



Via Facsimile

December 4, 2009

The Honorable Barney Frank
Chairman, House Committee on Financial
Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member, House Committee on
Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Paul E. Kanjorski
Chairman, Subcommittee on Capital
Markets, Insurance, and Government
Sponsored Enterprises
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Scott Garrett
Ranking Member, Subcommittee on
Capital Markets, Insurance, and
Government Sponsored Enterprises
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank, Subcommittee Chairman Kanjorski, Ranking Member Bachus, and
Subcommittee Ranking Member Garrett:

I am writing on behalf of the Council of Institutional Investors (“Council”), a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.

As a leading voice for long-term, patient capital, the Council supports your outstanding efforts to reform the regulation of the U.S. financial system. We are pleased that a number of the key provisions of *The Wall Street Reform and Consumer Protection Act of 2009* (“Act”) align with the Council’s regulatory reform priorities.¹

¹ For an overview of the Council’s corporate governance reform priorities, please see our December 2008 letter signed by representatives of over 40 member funds, available online at <http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Corporate%20Governance%20Reform%20Advocacy%20Letter.pdf>. For more information about the Council’s Corporate Governance Policies and other official policy statements such as our statement on the Transparency, Independence and Oversight of Financial Gatekeepers, please visit <http://www.cii.org/policies>.

In particular, the Council is most encouraged that the Act includes reforms designed to strengthen corporate governance, enhance the oversight and accountability of credit rating agencies, establish meaningful regulation of over-the-counter (“OTC”) derivatives, and bolster the resources of the Securities and Exchange Commission (“SEC” or “Commission”).² There, however, are two related provisions of the Act—Sections 7415 and 7606—that we strongly oppose. Those provisions would further defer and exempt, respectively, for most public companies full compliance with the internal control requirements of the Sarbanes-Oxley Act of 2002 (“SOX”) and thereby allow more errors and fraud into public company financial reports to the detriment of investors and the capital markets. We would strongly support any efforts to eliminate these harmful and unnecessary provisions from the Act.

Strengthen Corporate Governance

The global financial crisis represents a massive failure of oversight. In order to restore trust and reduce the possibility that such a crisis may reoccur, regulators and investors must be given the tools necessary to guarantee robust oversight and meaningful accountability of corporate managers and directors. Investors in particular need stronger market-based tools to hold boards accountable. The key corporate governance improvements included in the Act would provide for more meaningful oversight by public companies’ owners—their investors. Such measures would address, at least in part, some of the key problems that led to the current crisis. More importantly, they would empower shareowners to better anticipate and monitor future risks. Many of the corporate governance enhancements included in the Act are supported by both longstanding Council policy and the recommendations of the Investors Working Group (“IWG”)—recommendations that our members recently endorsed.

- *Shareowner Access to the Proxy.* The only way that shareowners can present alternative director candidates at a U.S. public company is by waging a full-blown election contest. For most investors, that is onerous and prohibitively expensive. A measured right for investors to place their nominees for directors on the company’s proxy card would overcome these obstacles, invigorating board elections and making directors more responsive, thoughtful and vigilant. By reaffirming the SEC’s authority in this area, the Act assists the Commission’s efforts to issue and implement a uniform proxy access rule without further unnecessary and costly delays.
- *Shareowner Vote on Executive Compensation.* Perverse executive pay incentives encouraged excessively risky behavior by financial firms that contributed to the current financial crisis. An advisory shareowner vote on executive compensation and golden parachutes as provided in the Act would induce compensation committees to be more careful about doling out rich rewards and provide boards with useful information about whether investors view the company’s compensation practices to be in shareowners’ best interests.
- *Compensation Committee Independence.* Compensation committees and their external consultants play a key role in the pay-setting process. Conflicts of interest contribute to a ratcheting up effect for executive pay, however, and should thus be minimized and disclosed. Reforms included in the Act would help ensure that compensation committees are free of conflicts and receive unbiased advice.

² For information about the Council’s views on reform in areas beyond corporate governance, please see the Investors’ Working Group July 2009 report, *U.S. Financial Regulatory Reform: The Investors’ Perspective*, available online at <http://www.cii.org/iwglInfo>.

Enhance Oversight and Accountability of Credit Rating Agencies

Credit rating agencies are financial “gatekeepers” to the capital markets. Their ratings enable companies to sell debt and give investors critical information they need to make informed investment decisions. Despite their semi-official status, rating agencies that are Nationally Recognized Statistical Rating Organizations historically have faced minimal regulation. Accordingly, it is not surprising that rating agencies were at the heart of the global financial crisis. Wildly inflated ratings of structured financial products helped to fuel the financial meltdown. The Council generally supports your efforts to restore the credibility of credit rating agencies as trusted financial gatekeepers. In line with both the Council’s policy statement on the Transparency, Independence and Oversight of Financial Gatekeepers as well as the recommendations of the IWG, we generally support the Act’s reforms designed to enhance SEC oversight of credit rating agencies, strengthen their governance and internal controls, improve the transparency of rating methodologies and assumptions and make rating agencies truly accountable to the investors that depend on them.

Establish Meaningful Oversight of OTC Derivatives

Unregulated trading in OTC derivatives contracts, especially credit default swaps, was at the heart of the global financial crisis. The global OTC derivatives market is enormous, yet virtually exempt from all regulation under the Commodity Futures Modernization Act of 2000. Prices are hidden, speculation is rampant and leverage is high. Although derivative contracts can help manage risk, left unchecked, they can also multiply and spread risk throughout the financial system, increasing the possibility of enormous damage. The Council generally supports your efforts in the Act to bring greater regulation and transparency to this highly influential market. Like the IWG, we believe that the best way to ensure effective government oversight and a stable trading environment is to require all standardized and standardizable OTC derivative contracts to trade on regulated exchanges and clear centrally. Exchange trading provides the transparency that investors such as Council member funds need to comparison-shop and ultimately pay lower transaction fees—leaving more assets available for pension fund beneficiaries.

Bolster the Resources of the SEC

Above all, financial regulators must be committed to promoting policies that are good for consumers, investors and the U.S. capital markets. The financial crisis has demonstrated, however, that regulators lacked the knowledge and resources needed to flexibly respond to rapid financial innovation and market expansion. Poor funding of some federal regulators, including the SEC, clearly helped to undermine vigorous regulatory oversight. The Council, therefore, generally supports the provisions of the Act that would increase SEC funding. Enhanced funding for the SEC is critical to planning for the long term and being better able to respond to future risks. Additional funding would also further ensure that the Commission has a workforce of sufficient size and skill to oversee the nation’s securities markets, including potential expansions into areas such as OTC derivatives and private fund advisers.

Remove Provisions Exempting or Further Deferring Full Compliance with Internal Control Requirements

Section 404 is a “key provision” of SOX and plays a vital role in ensuring high quality financial reporting and enhancing investor confidence in the markets. Consistent with the language and intent of Section 404, we have long held the view that any company tapping the public markets to raise capital should be required to have appropriate internal controls in place that have been subject to a meaningful review and attestation by external independent auditors. The need for strong internal controls is particularly important for the generally riskier smaller public companies that would be the beneficiaries of the Act’s provisions. Another study issued just this week confirms that when a public company’s outside auditors are not involved in attesting to the company’s internal controls the rate of accounting errors and restatements for those companies are much higher and the amount of time before the errors are found, publicly disclosed, and corrected is much longer.³ If, after more than seven years since enactment of SOX, and the issuance of volumes of implementation guidance, a public company or its external auditors have not yet been able to properly plan for a cost-effective and efficient auditor attestation of their internal controls, we believe it is in the best interests of all investors and other capital market participants that those companies and their external auditors be excluded from accessing the many benefits derived from participating in our public markets. We, therefore, strongly oppose the Act’s provisions that exempt or further defer full compliance with the internal control requirements of Section 404, and respectfully request that those provisions be removed from the Act.

Thank you again for your outstanding leadership in pursuing these necessary reforms of our U.S. financial regulatory system. If you have any questions about the Council’s views on the Act or any other matters, please do not hesitate to contact me at (202) 261-7081 or jeff@cii.org, or Council analyst Jonathan Urick at (202) 261-7096 or jonathan@cii.org.

Sincerely,



Jeff Mahoney
General Counsel
Council of Institutional Investors

³ See Mark Cheffers et al., *Audit Analytics, Restatements Disclosed by Two Types of SOX 404 Issuers: (1) Auditor Attestations Filers and (2) Management-Only Report Filers* 1 (Nov. 2009) (on file with Council).